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Crowdfunding brings new opportunities for CPAs

As crowdfunding continues to take off, CPAs can help small and medium-size enterprises navigate the complexities of this new sphere.

By Courtney L. Vien

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It started with a hoverboard.

When Barrett Young, CPA, and Challen Edwards, CPA, co-founders of niche accounting firm The Green Abacus, saw that Hendo Engineering was raising money for a hoverboard on crowdfunding site Kickstarter, they knew they had stumbled onto something big.

"I grew up watching *Back to the Future*," Young said. "I thought, 'This is the future! This is who I want to be helping!' " After some planning, Young and Edwards decided to make startup companies using crowdfunding a major focus of their business.

Advising companies on how to run their crowdfunding campaigns, they said, is a great way to tap into the excitement of crowdfunding and have a stake in bringing innovative products to life. "Crowdfunding gives business owners who believe in their ideas a chance to sell their story," Young said. "When we work with them, we become believers in their products also."

What's more, the crowdfunding sphere is brimming with opportunities for CPAs to start new lines of business. The three basic types of crowdfunding are discussed below.

CROWDFUNDING: THE BASICS

Reward-based crowdfunding

Reward-based crowdfunding involves raising capital by soliciting small amounts of money from a large number of investors, usually over the internet. It has become an increasingly popular way for small businesses to secure capital. On platforms such as Kickstarter and Indiegogo, individuals and companies offer consumers products, merchandise, experiences, or other perks in exchange for pledging money to help them bring a project to life. These projects range from service-based businesses such as restaurants, to creative endeavors such as films, TV shows, and graphic novels, and to products such as gadgets and clothing.

For example, one recently completed campaign on Kickstarter was for The Coolest Cooler, a combination cooler and blender with a built-in wireless speaker (kickstarter.com (https://www.kickstarter.com/projects/ryangrepper/coolest-cooler-21st-century-cooler-thats-actually/description)). Backers could pledge anywhere from $5 to $2,000 and receive rewards ranging from creator Ryan Grepper's signature on a cooler to having Grepper fly out to their home to tend bar at an event. For a pledge of $185 ($165 for early birds), backers would get a cooler.

Project creators set a fundraising goal to be met within a certain period of time. In most cases, funding is all-or-nothing: If users fail to meet their goal, they receive no money, and their backers are not charged. If they do meet their goal, the platform typically collects a percentage of the funds they raised as a fee. Kickstarter, for example, charges 5% of funds raised, and its payment processors charge fees of around 3% to 5%.

Equity crowdfunding

Though reward-based crowdfunding is the more familiar face of crowdfunding, companies also practice equity crowdfunding, in which they sell their securities to a large number of investors. Once, only accredited investors using licensed online portals or broker-dealers could buy securities from crowdfunded companies.

SEC regulations released in March 2015, however, have opened up equity crowdfunding to a wider pool of investors. These rules allow businesses to raise up to $50 million in 12 months and accept investments from unaccredited investors. There are no limits on how much an individual can invest in a Tier 1 company—one with an offering size of $20 million or lower. Individuals can invest up to 10% of the greater or their annual income or net worth in Tier 2 companies: those with an offering size between $20 million and $50 million.

Tier 1 companies must have their financials reviewed by an accountant, while Tier 2 companies must have their financial statements audited and publish annual reports. Tier 2 companies are also exempt from the requirement to register their offerings in each state in which they sell securities.

The full text of the rules is available at sec.gov (http://www.sec.gov/rules/final/2015/33-9741.pdf). The AICPA's letter to the SEC on its proposed version of the rules is available at aicpa.org (http://www.aicpa.org/advocacy/issues/downloadabledocuments/aicpa-letter-to-sec-re-file-s7-09-13-crowdfunding.pdf).

Donation-based crowdfunding

Donation-based crowdfunding enables individuals, groups, and not-for-profit organizations to raise money on sites such as GoFundMe and YouCaring. Users can raise funds for almost any charitable cause, including a family member's medical bills, rebuilding a house destroyed by a natural disaster, or sending schoolchildren to a competition. Some charity crowdfunding sites charge organizers a percentage of funds donated, while others, such as YouCaring, are free except for the fees levied by payment processors. Typically, the pledges received from donation-based crowdfunding are considered gifts and therefore are not taxable to the campaign creator.

THE RISE OF CROWDFUNDING

Crowdfunding is growing at an explosive rate. In 2014, $16.2 billion was raised through crowdfunding worldwide, more than double the $6.1 billion raised in 2013. Individual companies have raised remarkable amounts. In just 28 hours, the Pebble smartwatch brought in $1 million on Kickstarter; it raised over $10 million in its first campaign and over $20 million in its second.

Experts predict that the crowdfunding phenomenon will continue to grow. "We're just on the cusp of it now," said David Piscorik, CPA, director of the business resource group at Stancil & Co. U.S. small businesses are worth billions. "If just a fraction of them use crowdfunding, that adds up to a lot of access to investment."

It's not difficult to see why small business owners have been quick to adopt crowdfunding. Compared to other ways of raising capital, it's relatively streamlined, harnessing the internet's power to bring companies and investors together.

"Before crowdfunding, capital seekers had to knock on doors, make appointments, and go to events," said Phillip Laycock, CPA, a partner at Grassi and Co., who is partner in charge of the firm's Crowdfunding Initiative. "That still happens, of course, but now they can go to four or five online portals instead of 40 or 50 appointments."

Some companies use crowdfunding as an alternative to bank loans. Crowdfunding emerged in the wake of the Great Recession, said Sean Steigerwald, co-founder of equity crowdfunding site Malartu, when banks became more reluctant to make small business loans, and frustrated business owners sought alternate means of raising capital. "For a number of years, it's been very difficult for companies to find capital through more traditional channels," he said. "But things evolve when markets get tight."

Crowdfunding is also a way for companies to see if there's demand for a product or service before they launch it. They can start a campaign with a prototype or business plan, and then, if their idea doesn't catch on, they don't have to spend more money on research and development. If it does, they have funding and "a ready-made customer base on day one," said Mac McSwain, CPA, co-founder and director of McSwain Hiott. "With a bank loan, you've got no guarantee that your product will sell."

Proponents of crowdfunding believe that it will democratize investing. According to Piscorik, it helps companies "reach a wider pool of people who may not want to commit a big portion of their portfolio to one company." This influx of new investors, he said, will benefit small businesses and, in turn, the economy as a whole.

Crowdfunding is not without its problems, however. Startups have a high failure rate, and the relative ease of participating in crowdfunding (as opposed to finding venture capital or securing a bank loan) means it attracts novice entrepreneurs, some of whom are not well-prepared to launch their businesses. Companies that do make their funding goals may founder later on and fail to deliver the products they promised or cause shareholders to lose their investments. Moreover, experts have raised concerns that opening up equity crowdfunding to unaccredited investors will lead amateur investors to make poor decisions.

CROWDFUNDING OPPORTUNITIES FOR CPAs

Despite the risks associated with crowdfunding, however, some CPAs see it as an exciting area of opportunity. Though it is a relatively new sector of the economy and depends on technology, Young and Edwards believe those aren't reasons for CPAs to shy away from it. "Crowdfunding's not something mystical," Young said. "It's just a different way of raising capital." Many startups and small businesses fail, they pointed out, regardless of how they're funded.

The crowdfunding arena offers CPAs many chances for new business. For one thing, crowdfunding makes a company's finances more complex. "It adds a whole new layer of accounting for the small business owner," Piscorik said. "Their tax returns will become more complicated." Small businesses that have equity investors, he said, "are going to need better bookkeeping and records, and get information to investors in a timely and accurate manner."

Aside from doing traditional accounting services such as bookkeeping for new companies financed by crowdfunding, CPAs also will be needed to advise startups that plan to raise money through crowdfunding. "Small businesses that use equity crowdfunding are not just 50-50 owners," Piscorik said. "They're answering to many outside investors. There's more pressure on that company to succeed and grow, and there are opportunities for CPAs to advise in that growth."

CPAs can also help new organizations keep their investors better informed. "They can make business cases ... or product launches, provide projections of potential growth, and estimate investors' ROI on small businesses," Piscorik said.

The laws, regulations, and tax implications surrounding crowdfunding are complex and uncertain, and CPAs can help clarify them for new companies, Steigerwald said. "There are many unanswered questions about crowdfunding, especially about tax," he said. "Companies aren't sure what their responsibilities are with equity deals. They don't always understand what giving rewards means, or realize how much they'll be taxed. They need to work with accountants to understand the implications of rewards."

CPAs can also help companies minimize the risks inherent to crowdfunding. Fledgling companies don't know exactly how much they'll make with a given campaign—unlike with venture capital or a bank loan, where they receive a set amount—and that can make it hard to estimate costs and to price products correctly. CPAs can run projections for different scenarios to give startups a better idea of what to expect.

"Crowdfunding campaigns fail when companies underestimate or overestimate how much they need to raise," Young explained. Raising too much money can be as detrimental to a firm's fortunes as raising too little. Unexpected success "can totally change your costs," McSwain said. "Can you fulfill your orders? Can your factories meet the demand? You need to have those scenarios worked out in advance."

And now that equity crowdfunding has become a reality for U.S. businesses, another new line of business will open up for CPAs: reviewing and auditing crowdfunded companies' finances.

CPAs can also help companies contend with the complexities of handling securities. "We can help them get ready to make an exempt offering by preparing their forms and disclosures or doing their reviews or audits," Laycock said.

Accountants will even find new opportunities working with crowdfunding platforms, Laycock said. "Crowdfunding has created a whole new cottage industry of platforms and technology companies," he pointed out.

Finally, CPAs may also play a role in educating investors, and even the general public, about crowdfunding by publishing content such as articles and blog posts, and hosting seminars or webinars.

Even if CPAs don't plan to work directly with crowdfunded companies, it's still a good idea for them to be knowledgeable about the phenomenon, Young said. "It's just become so popular that it's something CPAs need to know about in case clients start asking about it," he said.

Though the crowdfunding sphere is still very much in flux, it looks as though it's here to stay. CPAs have the financial acumen necessary to help companies navigate this sometimes-risky territory and make their mark on the industry. As Steigerwald put it, "The work that goes into crowdfunding has a lot to do with good accounting."

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***JofA* articles**

- "Crowdfunding Poses Benefits, Risks (/news/2014/feb/20149550.html)," Feb. 5, 2014
- "New Opportunities for CPAs in Proposed Crowdfunding Rules (/news/2013/oct/20138976.html)," Oct. 23, 2013

***The Tax Adviser* article**

"Tax Clinic: Crowdfunding Contributions and State Sales and Use Taxes (/issues/2015/jun/tax-clinic-08.html)," June 2015, page 420

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"AICPA Survey Shows Sharing Economy Has Potential," April 29, 2014, aicpa.org (http://www.aicpa.org/press/pressreleases/2014/pages/aicpa-survey-sharing-economy.aspx)

Online tools

Addressing Small Business Client Concerns, aicpa.org (http://www.aicpa.org/interestareas/privatecompaniespracticesection/practicegrowth/pages/client-concerns.aspx)
